



INCOME ASSIGNMENT CONTRACTS: ARE THESE SIMPLY INDENTURED SERVITUDE CONTRACTS WITH A NEW NAME?

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Introduction

As undergraduate student debt continues to mount, there is an active search for alternatives to student loans. As a Wall Street Journal opinion piece noted, the average debt load for students graduating in 2015 was \$35,000, the highest debt load per student to date.¹ The problem with an average is that some students will have less debt, but just as many students are carrying even heavier loads. Furthermore, the federal student loans market has created a bubble – investors have begun betting against the market due to its \$1.2 trillion² in size and about \$100 billion of federal student loans being in default, 9 percent of outstanding balance³.

Because of the ever-increasing post-graduation debt burden and its rippling repercussions across recent graduates' lives,⁴ policymakers and college administrators are on the hunt for new solutions. One of those solutions may be an old idea in new packaging. Specifically, Income Share Agreements, which can look an awful lot like indentured service contracts from hundreds of years ago.

The basic idea behind an Income Share Agreement is that the student commits to pay investors a certain percentage of the student's income for a certain number of years post graduation. During their time in college, they draw money from a pooled investment fund. In exchange, they pay a percentage of their income post-graduation for a fixed term. The investors take a gamble that the student will be able to pay over that time, and the student takes the risk that these payments will be less draconian than student loan payments.

Is this the best idea? The best vehicle for tackling the growing debt problem? It is one that legislators, including Presidential candidate and U.S. Senator Marco Rubio,⁵ in the United States are considering as they struggle to cope with a looming student debt crisis that could be the next big crash.⁶ In fact, investors are already beginning to bet against the bubble: some calling it the "biggest risk in the credit market" are treating the student loans market similar to the mortgage market which historically crashed in 2008.⁷ This paper will examine the historical framework of indentured servitude contracts as well as the more modern Income Share Agreements. This issue caught the authors' attention because Purdue University President Mitch Daniels announced in August he is actively looking for investors who are open to investing in Purdue students as an alternative to the ever mounting student loans.⁸

Experts Expect Income Share Agreements to Work

Income Share Agreements are not a new idea. In 2002, CATO, a U.S. based Libertarian think-tank headquartered in Washington, D.C., published a paper analyzing the merits of the idea – then called Human Capital Contracts.⁹ In an article at EdCentral, Alexander Holt compares Income Share Agreements (ISAs) to private student loans and federal student loans.¹⁰ In both cases he believes students are better off with the ISA because the uncertainty of a job and future income does not effect the requirement to pay back private or federal student loans, but it would have an effect on the ISA.¹¹ To wit: "With a private loan, a student knows what the payments will be but not if they will be affordable. With an ISA, the payments are unknown but will be affordable."¹²

Some argue this is similar to an already existing tool the government provides: the Income-Based Repayment Plan (IBR), which provides that a student would pay up to 15% of income but never for more than 25 years for those who initiated their federal student loan before July 1, 2014.¹³ For those who initiated after July 1, 2014, an IBR will never be for more than 10% of income over a 20-year period.¹⁴ In both situations, the graduate will never pay back more than they would have under the 10 year standard repayment plan. Interesting to note: 1 in 5 borrowers using a IBR still default on their loans.¹⁵

What critics do agree is that stronger legal protections need to be in place before ISAs will make contract sense for the students and the investors.¹⁶ Legislation introduced by Senator Marco Rubio¹⁷ and most recently by Representatives

Young (of Indiana)¹⁸ and Polis¹⁹ would provide a legal framework for these agreements that don't fit squarely in any current area of contract law.

But our initial prose still remains: are ISAs akin to indentured servitude? In an article in the August 4, 2015, issue of US News & World Report, Kevin James argues that they are not. Instead, Mr. James states that unlike indenture servitude where the worker pledges future labor and surrenders free will, with ISAs, it is simply a contract to receive money today in exchange for the possibility of repayment in the future.²⁰

An idea the American public thought to be obsolete has decided to rear its potentially ugly head in the market but the question now becomes: where are the legal boundaries circa 2016 as it has to do with education? Some companies have begun betting on people – providing an investment and asking for a return from the person's earnings. We will provide a historical analysis of labor law as well as case law, which will provide a better understanding of the boundaries this practice, will allow in the modern era. This paper seeks to differentiate between corporate exploitation and investment in human capital and provide answers to questions raised in the category.

In the analysis, the paper will first look at indentured servitude contracts and then compare them to the types of agreements currently proposed by the proponents of human capital contracts or Income Share Agreements (ISA).

In the early 1960s, economist Milton Friedman wrote extensively about the "Role of Government in Education." Friedman argued that it was a necessity for a stable society to have an educated public but the burden of educating shouldn't fall entirely upon the government. He wrote, "If the financial burden imposed by such a schooling requirement could readily be met by the great bulk of the families in a community, it might still be both feasible and desirable to require the parents to meet the cost directly. Extreme cases could be handled by special subsidy provisions for needy families."²¹ Friedman's reasoning was this policy could close the unnecessary holes in a tax loop – "This would eliminate the governmental machinery now required to collect tax funds from all residents during the whole of their lives and then pay it back mostly to the same people during the period when their children are in school."

The proposed ISAs which are currently in the market would work as follows: prior to entering college, a typical high school student will seek funds from an investor to lend money with the condition that a percentage of the student's yearly income – over a set period following college graduation – will be used to pay back the initial investment. The investment will be different from a governmental loan where a student has to pay a fixed sum plus an interest rate until the initial sum borrowed plus the accrued interest is truncated. The question becomes does a high school senior or junior bear the capacity and negotiation acumen to successfully contract with a private investor to fund their higher education and if so where lies the imbalance of the power in those negotiations?

Current federal loan plans:

The U.S. government currently offers two types of loans to undergraduate degree seekers: subsidized and unsubsidized loans. Subsidized loans have a current interest rate of 3.86 percent with unsubsidized loans at 4.66 percent. For students seeking a loan for graduate degrees, the current rate is 6.21 percent. The calculation of the interest rate is based on a congress devised formula: after completion of the degree, by multiplying the loan balance by the number of days since the last payment times the interest rate factor.²² TICAS or the The Institute for College Access and Success calculates that an "average figure of \$26,600, compounding for interest year over year using the 10-year-payback plan that is the standard, the total cost of your \$26,600 loan is about \$38,600. Break that down by monthly payments and you are looking at about \$320 per month going toward student loan payments."²³

The rising costs of education do not mesh with the outlines of this plan. The total student loan debt in the U.S. is a startling \$1.2 trillion — \$1 trillion of that number is in federal student loan debt²¹. The culprits here are two fold. First, overall education and tuitions prices rose 22 percent between 2005-2014. Thus more loans are being taken out and more borrowers getting hit with fees and penalties.²⁴ Secondly because of an expansion of skills demanded by the market due to technological growth and related externalities (between 1950 and 1997, the proportion of American jobs classified as unskilled dropped precipitously from 80% to approximately 15%), there is growing demand for college education.²⁵

As anyone who has played the board game of LIFE learns, Higher education is a successful business model because it promises students, in general, very high fiscal rewards, that a person generally couldn't receive in other tracks. According to the National Center for Education Statistics in, "2012 the median of earnings for young adults with a bachelor's degree was \$46,900, while the median was \$22,900 for those without a high school credential and \$30,000 for those with a high school credential."²⁶ This simply means — on average — to gain income power, most individuals have to attain some form of higher education.

The government's own income share agreements:

The U.S. government has its own form of an ISA called Income-driven repayment plans. There are three plans the Department of Education currently utilizes: the Income-Based Repayment Plan (IBR Plan), Pay As You Earn Repayment Plan (Pay As You Earn Plan) and Income-Contingent Repayment Plan (ICR Plan). Essentially, the income-driven repayment plans are designed to make student loan debt more manageable by reducing the monthly payment. The percentage of income demanded for these plans is a significant sum, as listed below, — more than what we have seen for privatized investments — however, education pundits argue these are "safer" options for funding education due to the fact that these are governmental plans rather than a private individual offering to negotiate for a potential return on his or her investment.

The plans²⁷ and the percentages of income demanded in return are listed below:
IBR

Post July 2014, Generally 15 percent of your discretionary income, but never more than the 10-year Standard Repayment Plan amount. (Prior to July 2014, the figure was 10 percent of discretionary income.)

Pay As You Earn Plan

Generally 10 percent of discretionary income, but never more than the 10-year Standard Repayment Plan amount.

ICR Plan

The lesser of the following: 20 percent of discretionary income or what graduate would pay on a repayment plan with a fixed payment over the course of 12 years, adjusted according to income.

If we use the figures from National Center for Education Statistics, 10 to 15 percent return would range from \$4,690 to \$7,035 on a yearly basis for a student who has an undergraduate degree. The bigger problem, as aforementioned, comes with the interest rates on these plans. The Federal Student Aid website actually warns students by stating, "Whenever you make lower payments or extend your repayment period, you will likely pay more in interest over time—sometimes significantly more. In addition, under current Internal Revenue Service (IRS) rules, you may be required to pay income tax on any amount that is forgiven if you still have a remaining balance at the end of your repayment period for an income-driven repayment plan²⁸." This could send a student — theoretically a consumer who contributes to the GDP of the country — into a heaping debt spiral.

ISAs and indentured servitude:

The resurfacing of privatized ISAs demonstrate there could be a market-based solution to a giant problem in the current education system. Notice the length of the programs offered by the federal government: the maximum time frame is a 12 year contract which we will see to be one of the main differences in the discussion about the private ISA contracts proposed now. The idea behind these ISAs is the same as any other capital investment — the goal, for the investor, is to profit from his or her investment. Bargaining position remains a crucial element as a lack there of could be perceived as exploitation by the investor class. The reason this paper seeks to compare and contrast ISAs to indentured servitude contracts is because the ambiguity related to ISAs mimics indentured servitude contracts.

As aforementioned, one of the biggest concerns about ISAs is the bargaining position of the student. Does the student have the capacity to negotiate with an investor on a capital based contract? While the students we are considering in this paper are of legal age to negotiate a contract, can an 18 year old understand the restrictions and burdens a contract like the ISA creates?

A Southern Methodist University law professor, Gregory Scott Crespi, wrote for the SMU law review that he teaches his students contract law through the eyes of indentured servitude and sharecropping contracts.²⁹ Crespi wrote that recruiters would go into the British slums of London and Liverpool to recruit the desolated population for the opportunity to work in the New World. The recruiters,

"would get them to sign contracts where they agreed to work for an employer in the New World for seven years in exchange for ship passage and room and board during the seven-year work period, after which time they would be free to seek their fortunes amidst the many proclaimed opportunities of the New World. However, the contracts were full of nasty fine print, as you might imagine, allowing the employers to impose harsh corporal punishment such as floggings and the like should the workers not do their assigned work or attempt to quit before the seven years were up. But starving people just looking for a chance to survive and get a new start in life were willing to sign up; and, of course, most of them were illiterate and could not have read the contractual fine print even if they had tried to do so."³⁰

A similar concern arises from ISAs. What punishments will a student face if he or she diverts from the contracted major or graduation year? Investors, practically speaking, seek the quickest and highest return on their initial investments. It is no secret that a career track in STEM (science, technology, engineering and mathematics) offers individuals the highest starting salary. So an investor could potentially limit the flexibility of a student changing their major given that the difference in starting salaries between STEM individuals and Liberal Arts fields is a stark one, often north of \$10,000. Engineering students average \$56-57,000 as a starting salary, while students who major in liberal arts areas like psychology and social work earn closer to \$37,000.³¹

Another point to raise is the length of time it takes for college graduates to obtain employment post-graduation. Research indicates that 61% of college students will change their major at least once while in college. How could an individual entering college foresee how long it would take them to land a salaried position? Money Magazine suggests it takes 3-9 months to land that first job after college. If recent graduates aren't prepared for that length, it can impact the ability to start paying back on these contracts. This is corroborated by research from the Economic Policy Institute and Federal Reserve Bank analysis of Census Data.

Still college is generally worth the investment. Research shows that there is a pay gap between those who have a bachelor's and those who don't.³⁴ Thus, it's more important to evaluate these new funding vehicles to see whether they are a good option for college students who want the advantages of the college degree without being saddled with the mounds of student debt.³³

Continued discussion: An example of an Indentured Servitude contract

"THIS WRITEING INDENTED made the Last day of July/ Anno Dom 1627 And in the Third year of the raigne of our Sovraigne Lord Charles by the Grace of God king of England Scotland France and Ireland Defender of the faith &c. betweene Richard Lowther of Broome in the Parish of South well [i.e., Southill] in the County of Bedford brewer of thone party and Edward Hurd Cittizen and Iron monger of London of thother party witnesseth that the said Richard Lowther (for the Considerations here in after Mentioned) hath hired himselfe and is become and by theis presents doth Covenant and agree and bind himselfe to be remayne and Contynue the Covenant servant of him the said Edward Hurd his heirs and assigns to be by him or them sent and transported unto the Cuntry and land of Virginia, in the parts beyond the Seas & to be by him or them employed upon his plantation there, for and dureing the space of Fower yeares to begin at the feast day of St. Michael Tharchangell now next comeing dureing which said terme the said Richard Lowther shall and will truely employ and cnd [sic] endeavour himselfe to the utmost of his power knowledge and skill to doe and performe true and faithfull service unto the said Edward Hurd his heirs and assigns in for and concerning all such Labour and businesse as he or they shall think good to use and employ him the said Richard Lowther in, And shall and wilbe tractable and obedient as a good and a faithfull servant ought to be in all such things as shalbe Comannded him by the said Edward Hurd his heires or assigns in Virginia aforesaid or elsewhere dureing the said terme. IN CONSIDERATION whereof the said Edward Hurd for himselfe his executors administrators or assigns and for every of them do covenant promise and grant to and with the said Richard Lowther his heires executors administrators and assigns by theis presents that he the said Edward Hurd his heires executors administrators and assigns shall and will (att his and their owne charges) not only transport and furnish out the said Richard Lowther to and for Virginia aforesaid and there find provide and allow unto him sufficient meate drink apparrell and other necessaryes for his livelihood and maynetenance duringe the said term But alsoe at the expiration of the said terme shall and will graunt assign and allot unto him the said Richard Lowther the quantety of Fifty acres of Land in Virginia aforesaid to hold to him his heires and assigns for ever as in such Cases usuall without fraud or Coven In witness whereof the said parties to theis presente wryteings indented Enterchangeably have sett their hands and seales given the day and year first above writen."³⁵

If we were to look at this document within the framework of what makes an enforceable contract today, we can further compare it to ISA agreements. We can assume there was an offer and acceptance between Richard Lowther and Edward Hurd as there are witnesses present at the writing of the contract. Lowther has agreed to be, "transported unto the Cuntry and land of Virginia, in the parts beyond the Seas & to be by him or them employed upon his plantation there, for and dureing the space of Fower yeares." We know that there is an established period of time for the employment of Lowther by Hurd. The contract continues to stipulate that, "

Lowther shall and will truly employ and end [sic] endeavour himself to the utmost of his power knowledge and skill to doe and performe true and faithfull service unto the said Edward Hurd his heirs and assigns in for and concerning all such Labour and businesse as he or they shall think good to use and employ him the said Richard Lowther in, And shall and wilbe tractable and obedient as a good and a faithfull servant ought to be in all such things as shalbe.”

Hurd in exchange will pay for Lowther's passage, housing and meals. At the end of the tenure, Hurd will allot Lowther 50 acres of land in Virginia.

There remains ambiguity in this contract. Lowther is set to perform any and all services which Hurd and his heirs deem necessary as long as they are in the scope of whatever “Labour and businesse” defines — so there are no set tasks or series of tasks to which Lowther is bound. His skills as a laborer are not defined, so he is set to do any and all work Hurd's heirs deem fit for whatever period of time within the four year period. The stated term of four years is riddled with ambiguity as well as it doesn't define whether the four years is equivalent to 1,460 days of work or whether Lowther has the ability to take days off and still have those count towards the four year total. Health concerns and sick days are not accounted for in this contract either. On Hurd's side, the 50 acres of land in Virginia are not specific to any certain location or if that property can be used for farming or obtaining a livelihood.

We use this contract to raise questions of ambiguity in proposed ISAs. For example, does a student have the ability to switch majors during the period of investment? Will the student be limited to certain career fields or industries post-graduation? And what are the ramifications of not being obedient to the contract? We assume that a student will not be subject to lashings as indentured servants often were. But we remain curious as to what penalties students face should they divert away from the ISA and subsequently, what will be the flexibility displayed in ISAs?

Who is offering the ISA now?

Our search and analysis of modern ISA contracts must start from a legislative standpoint before we discuss further the potential legal issues that may arise. There a few legislative pieces to look at: a bill proposed in early 2015 by two Republican senators and an Oregon state law called “Pay It Forward.” Furthermore, we will analyze the private ISA contract offerings and visit the plan offered by Purdue's president Mitch Daniels. We understand that there are ISA contracts which exist outside of the higher education sector and those mentioned will be compared by analogy.

“Pay it forward”

The state of Oregon, in an attempt to create more affordable higher education, passed what is called the “Pay It Forward” bill. The bill signifies one of the first times in American history the idea of a human capital contract or income share agreement proceeded through the legislative process. The implementation of the bill will occur in 2015. The idea is simple, the state government funds a part of or the entirety of your education at the collegiate level provided you attend a state funded university. And the student agrees to pay back the advance: the more one earns, the more they pay back; the less they earn, the less the amount returned to Oregon. Under this scheme, the payments will start once the college graduate starts his or her first job. The program is geared to attract mainly two groups of students: students from mid-income families who didn't qualify for federal financial aid and others who wanted to pursue less lucrative fields like teaching.

Though the bill is designed to benefit all Oregon natives, there are some glaring problems facing both students and the sole investor, the state. It is a monopoly model of income share agreements. The key is that all attendees, whether or not they have graduated, must pay back three percent of their income over a 24-year span. The students, whether or not it is for their benefit, have no negotiating power as the state has a blanket percentage and time frame attached to this bill.

The problem is tri-fold. If a student does not graduate with a degree from the university, he or she still must pay back once employed whatever cost accrued during time at the college. Additionally, tuition costs are a fraction of what a student pays to attend college. In fact in most state funded universities, room and board, costs of living and textbooks comprise more than half a yearly tuition and there is no Pay It Forward coverage for those expenses. A key disadvantage for the state is the high initiation costs to launch this program. Moreover, the longer a student takes to graduate, the more it costs the state.

Rubio – Petri ISA

Senators Marco Rubio (R-FL) and Tom Petri (R-WI) proposed a more free-market solution with ISA in early 2015. The Rubio-Petri bill opens contracts up to private investors. This bill proposes that students would be subject to a minimum income exemption of \$10,000, a maximum repayment period of 30 years, and an aggregate limit of no more than 15 percent of the individual's income committed to ISAs. The bill offers some federal transparency on one of this paper's topics: where are the legal boundaries and who enforces them? The bill would give students some amount flexibility with investors unlike the Oregon model where students essentially had to deal with the monopolization of ISAs. Also, the bill would allow students to attend any school of their choice. One of the things to note is that the ISA proposed in the Rubio-Petri bill is not a debt

instrument, so students cannot default on their debts or discharge them in bankruptcy.

Daniels' “Bet on a Boiler”

In the early brainstorming stages of this paper, something interesting happened locally in relation to this topic: the Purdue president, very vocally, came out in support of income share agreements. Around mid march, reports of President Mitch Daniel, a former governor of the state of Indiana were released where he had mentioned that because he believes tuition is a rising problem in higher ed, he wanted to think about various ways to pay for college — what is more interesting is that, though a former conservative politician, he believes that action should be taken at the federal level. He, in fact, testified before congress promulgating the idea. “When I bring it up, people say, ‘Yeah, it's a great concept. But the law is not clear,’ Daniels told the Indianapolis Star after testifying before a House panel working on a higher-education bill.

For this paper, we wanted to pick the Purdue president's brain a bit, so we could have a better understanding of how an ISA plan would work in one particular university.

Purdue's Evergreen Fund: Bet on a Boiler.

“It just seems like a common sense thing to me.”

Those were the words used by Daniels as our interview began. Daniels thinks that the process should be looked at as an investment portfolio but he does think that investors need be wary about the lesser earnings potential.

As far the governmental involvement, he said, “You don't want the government in it. With the government involved as a third party subsidizer, its contributed to the increase in the cost of education.” Because of what Daniels and his cohorts believe to be ambiguity at the federal law level, he says that private citizens are going to “go anyway” and start creating mutual funds. That is where Daniels' plan for Purdue comes in.

For Purdue specifically, he believes that the plan would derive from the love that Purdue alumni have for the university — or targeting empathy investors who want to set up evergreen mutual funds. In this evergreen fund, when any return is made from the initial investment, the return or a percentage of that return goes back into the fund forming almost a cyclical dynamic. Bringing this back to ISA: the returns from one student that an investor may get over a period of time will be put back into the fund to potentially attract another student investment thus growing the size of the fund and diversifying its assets.

As far as bargaining positions for students go: Daniels believes in the Rubio-Petri planned discussed earlier in this piece (capping the rates at a maximum 6 percent return over a 15 year period). But he takes it a step further: he proposes that individual universities set their own rates that correspond with public policy — offering potential further protections for a student. This plan could be appealing to investors, especially the empathy sector, who are looking to simply give back to the University.

Daniels is counting on market factors to determine ROI rates as well as the time periods set. The other question becomes about the skewing of majors. As aforementioned in the paper, certain subject areas should be targeted more because they offer graduates a higher starting salary. Daniels believes that if the school were to be involved in the ISA process, some of that skewing could be deterred. He would ideally “package together” a variety of graduates to an investor, which could work to the advantage of students who are not in subject areas with the highest income potential.

Daniels fought some of his critics on this idea who claim that ISA could be considered indentured servitude by saying that “you can't force someone to work.” Technically, if a contract was written with no penalty for unemployment, Daniels is correct. However, if an investor is trying to protect his or her initial investment, it isn't a stretch to imagine that there will be a clause which stipulated a penalty.

The risk, in the current system, falls on the taxpayer as Daniels put it, “Joe-Schmo doesn't know what is happening to his money.” But he believes that these investors who invest in universities will not be seeking the highest returns but rather be using the funds as a way to simply give back to their alma mater. The investor will accumulate most of the risks but Daniels says that investors will know the risks prior to going into this arena.

Though this paper does not venture into mutual fund law, a reader should note the Investment Company Act of 1940 in order to get a better idea of the types of funds that could be set up ceteris paribus Daniel's initiative and also to raise questions about the classification of the education evergreen funds “Bet on a Boiler” suggests.

As it stipulates:

“The act divides the types of investment company to be regulated into three classifications: Face-amount certificate company: an investment company in the

business of issuing face-amount certificates of the installment type. Unit Investment Trust: an investment company which is organized under a trust indenture, contract of custodianship or agency, or similar instrument, does not have a board of directors, and issues only redeemable securities, each of which represents an undivided interest in a unit of specified securities; but does not include a voting trust. Management Company: any investment company other than a face-amount certificate company or a unit investment trust. The most well-known type of Management Company is the mutual fund."

Other education based ISAs

Lumni is an organization which manages funds in the human capital market space and focuses directly on education.³⁶ Lumni has financed nearly 7000 students since its inception in 2002 and claims that all or most are from low income backgrounds. The organization operates not only in the U.S. but also in Chile (where it was founded), Colombia, Mexico and Peru. However, only 27 of those students were from the U.S.³⁷

Like Lumni, there are a few other education based income share agreement plans on the private market like 13th Avenue funding and the Leff-Hughes Swap Transactions. 13th Avenue funding works like the ISA models discussed prior but seeks investors from a local area. The latter, Leff-Hughes Swap Transactions, is a plan for funding legal education where a student contractually signs with a financial institution and the financial institution seeks high returns when the student finds a vocational opportunity in Big Law.³⁸

The Upstart ISA

Upstart.com is a "peer to peer" or crowdsourcing platform where entrepreneurs can seek an investor who is part of the upstart community for an investment that can be used towards loans or root-funding for a new start-up. Upstart is a for-profit company and seeks a borrower's fee. Upstart does set a limit on the time frame of the ISAs offered on its platform: 5 years.³⁹ As the contract stipulates preliminarily, "This agreement is not a loan, the amount you must repay is not a fixed amount and will vary based on your income each year, as reported the Internal Revenue Service (IRS). "The company advertises on its home page that, "The average 3-year loan on Upstart will have an APR of 15% and 36 monthly payments of \$32 per \$1,000 borrowed. The average APR on Upstart is calculated based on 3-year rates offered in the last 1 month." However, Upstart shrewdly mitigates risks to investors via its contracts per the following:

- a. **Liquidated Damages:** Upon an Event of Default we may elect to recover liquidated damages from you for the remaining term of this Agreement in the following amounts:

$1 + (0.1 \times \text{number of years since receiving your Funding Amount, rounded up}) \times \text{Funding Amount}$

By way of example the liquidated damages for an upstart who receives a Funding Amount of \$10,000 on August 17, 2013, will equal \$11,000 ($1.1 \times 10,000$) if an Event of Default is declared by us on or before August 16, 2014, \$12,000 ($1.2 \times 10,000$) if an Event of Default is declared by us between August 17, 2014 and August 16, 2015, etc.

You agree that quantifying losses arising from a default by you is inherently difficult because your future income is not known and you agree that the above amounts are not a penalty, but rather a reasonable measure of our damages based upon our prediction of your income and our expected returns.

- b. **Other remedies:** Upon an Event of Default you agree that we are also entitled to calculable damages and to exercise all of the remedies available to us under law, including enforcing the performance of this contract in court or through binding arbitration.
- c. **Attorneys Fees and Other Expenses:** Upon an Event of Default, you agree to pay all costs of collecting all amounts due under this Agreement, including any liquidated damages, reasonable collection agency fees, and/or attorneys' fees, to the extent not prohibited by applicable law.

One theory could be that having Upstart "at the table" during a negotiation is of mutual benefit to both the investor as well as the borrower. The borrower gets a set time frame and also a chance to compare the offered investment to a market average within the platform, potentially eradicating problems of higher than norm APR rates as well as time frames arising from being the first entrants into a monopsony of sorts. The investor is protected via the contract mentioned as a default fee would be liable for $1 + (0.1 \times (\text{number of years since receiving Funding Amount}) \times (\text{Funding Amount}))$ in addition to legal fees and all calculable damages under law.

Negotiation and positions of power

Our discussion earlier about the capacity to negotiate and the emphasis of choice in contracts arises here. The privatization of these contracts puts more risk - whereas, the Oregon bill fixed the rates and time periods - on the heads of students. If we were to briefly look at case law, we can see that courts usually rule in favor of the contractor, if the contractee made the choice to agree to the

contract with reasonable intent.

If we look at *KAVENEY v. JOHN D. MILLER, HAROLD FULMER, and JUDITH FULMER*⁴⁰ from the eastern district of Pennsylvania, we can see how a district court ruled in a tenant-landlord dispute, which has strong similarities with a potential ISA dispute. The facts are: The tenant and his wife agreed to rent an apartment at the landlords' hotel. The tenant lost his job and was unable to pay his rent in full. The parties entered into an agreement under which the tenant performed maintenance duties on the hotel premises in order to compensate for the insufficiency in rent. The tenant was unable to perform his maintenance duties because of illness, and the landlords ordered them to vacate the apartment. An officer arrested the tenant, who spent ten days in jail, until the unfounded charges were dismissed.

The court determined that the tenant failed to allege all the elements necessary to maintain a § 1983 claim based on the Thirteenth Amendment. Not every situation involving a choice between labor or legal sanction constituted involuntary servitude. Specifically, "A condition of involuntary servitude exists when the victim has no available alternative but to work or be subject to legal sanction or physical harm."⁴¹ Furthermore, "[t]he essence of indentured servitude is the premise that the employee must have no other alternative."⁴²

In *Kaveny*, the tenant failed to show compulsion as a prerequisite in proving involuntary servitude because he was given a choice to leave the premises when he was unable to pay the rent. The tenant's allegations with regard to state action by the landlords were sufficient to state a cause of action because he alleged that he was arrested by the officer at the landlords' insistence and without probable cause.

The court granted in part and denied in part the landlords' motion to dismiss the tenant's § 1983 complaints. Plaintiffs have failed to allege the lack of availability of a choice. In addition, the complaint states that Thomas Kaveny involuntarily entered into the employment agreement with defendants because he did not want his wife and children on the streets.⁴³ Thus, plaintiffs clearly had an alternative and an opportunity to leave the premises when they were unable to pay the rent. Furthermore, the complaint contains no allegations of compulsion by the defendants to coerce plaintiffs into staying through physical or legal means. Accordingly, plaintiff failed to allege all the elements necessary to maintain a claim for involuntary servitude. Therefore, defendants' motion to dismiss for failure to state a claim shall be granted with regard to plaintiffs' § 1983 claim based upon a violation of the Thirteenth Amendment.

The key line in the decision remains "Plaintiffs have failed to allege the lack of availability of a choice." Similarly with ISAs, one could argue students have the choice to not agree to a contract with a private investor. The negotiation power remains mostly in the hand of the investors, until the market becomes starts to experience saturation. The Rubio-Petri bill, theoretically speaking, would create more competition amongst investors and shift some negotiating power back to students.

As this paper has shown, ISAs are a complicated addition to the student funding offerings. As graduate debt burdens continue to increase, it is clear that something must be done to provide an affordable alternative to students. The question remains whether ISAs when combined with legal protections are the next, best idea or are they more like their distant cousin the Indentured Servant Contract? We do not believe that there should be or even can be a boilerplate contract in this industry - due the need for personalization in each and every contract. The paper "Human Equity? Regulating the New Income Share Agreements" from the Vanderbilt Law Review argues for something similar. Though Oeim and Ring are not suggesting "that a unified framework will never be possible or desirable"⁴⁴, they do insist that ISAs be administered via a case-by-case approach rather than regulation (in both the legislative as well as the verbal sense) by analogy. This paper suggests something similar: much like the Upstart contract, when it comes to educational funding, make each individual school or a set of schools who participate in a mutual fund, a player during negotiations. The 'Bet on a Boiler' initiative as well as Lumni give us insights which say that ISAs could indeed become a tool not only just for international students but also because of a rapid growth in demand, here in the U.S. as well. The initial problem this paper wanted to target was the question of imbalance of power between a student and an investor. By making the university or college negotiate as a third party, investors would be able to mitigate risks due to policies set by the schools and students would be able to gain more flexibility and more bargaining rights due to the time frame and also the rate based on potential future income and school tuition which are determined largely by an individual institution. The legislation suggested currently remains too broad and thus is inept, currently, to handle this very delicate funding issues. We do foresee legislation being created at a federal and or state level in the future as the market players begin to show their heads.

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